6/1/88 R5650-2

JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

NO. 21B
May 27, 1988

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Forecasters Upbeat About Economy

The 3.7 percent real economic growth projected last December by Japan's private-sector economists seemed a remarkably rosy picture of the economy for the fiscal year starting in April 1988. After all, the yen was rising again before the economy had fully adjusted to the run-up that started in February 1985, and October's stock market crash was a fresh memory.

With the new fiscal year barely under way, many of the same forecasters now say they were too pessimistic in December. They are now expecting 4.3 percent real growth on average in FY 1988 (see Table). The biggest difference is the estimated strength of domestic demand. For example, NRI and NCC Co., Ltd. (Nomura Research) is now expecting domestic growth of 5.3 percent rather than

the 4.9 percent it projected in December. (For details of earlier forecasts, see JEI Report No. 8A, February 26, 1988.)

Summary of Revised Forecasts, FY 1988

	Real GNP Growth		Current Account	Y/$ Exchange	Oil Prices
	Initial	Revised	Surplus*	Rate	($/barrel)
Fuji Bank	3.7%	4.1%	$73.0	Y122.0	$16./
Industrial Bank of Japan	3.6	4.3	78.8	120.0	17.6
Japan Economic Research Center	3.7	4.2	75.0	120.6	18.1
Daiwa Securities Research Institute	4.0	4.7	72.7	122.8	16.5
Okasan Economic Research Institute	3.7	4.5	n.a.	124.0	18.0
NRI and NCC (Nomura Research Institute)	3.6	4.1	78.7	123.0	16.0
Average Forecast	3.7	4.3	75.6	122.1	17.2

*In billions of dollars.

Other parts of the forecasts have shown less change. The yen is still expected to be stable over the fiscal year. The predicted value of Y122.1=$1.00 rather than the 127.7 yen to the dollar estimated earlier mainly reflects the appreciation that occurred between the two forecasts.

With their new projections, private-sector economists are now more optimistic than the government, which is still expecting 3.8 percent real growth. The new estimates, however, are in line with the Organization for Economic Cooperation and Development's. OECD now predicts 4.25 percent real growth for Japan in calendar 1988, an increase over its December estimate of 3.5 percent. (In 1987 the economy grew 4.2 percent.) The new 1988 projection puts Japan substantially ahead of the 3 percent average for all OECD countries and the 2.75 percent forecast for the United States, both of which are also higher than earlier estimates.

The OECD projection differs somewhat from the projections of Japan's private-sector economists on the direction of the current account surplus. The latter forecasters estimate an average $75.6 billion surplus in FY 1988, down substantially from FY 1987's $84.5 billion figure but close to their earlier projection of $75.4 billion. In contrast, the OECD expects a surplus of $85 billion in 1988, virtually unchanged from last year's $87 billion. While any of these amounts would leave the current account surplus at a historically high level, private-sector Japanese economists are more optimistic that it will continue falling.

The OECD forecast is similar to the results of a new informal survey of trading companies and manufacturers by the Ministry of International Trade and Industry, which suggests that the customs-clearance trade surplus will be $76 billion in FY 1988, the same level reached in FY 1987 but higher than the official government outlook of $68 billion. MITI bases its conclusion in part on

resumed export growth. Overseas shipments were off 0.5 percent in volume terms in FY 1987 but are expected to grow about 2 percent in FY 1988 despite an average exchange rate of Y125=$1.00 instead of the Y138=$1.00 recorded in the April 1987-March 1988 period.

If these MITI and OECD forecasts are correct, the foreign sector will be neither an engine of growth, as it sometimes has been in the past, nor a drag on expansion, as it was in 1986 and 1987. American policymakers are likely to be pleased with the continued strong growth of the Japanese economy but unhappy that the trade surplus may remain around its present high level for the foreseeable future.

Douglas Ostrom

Japanese Continue To Buy U.S. Bonds

Despite wariness over rising U.S. interest rates and worries that recent exchange rate stability would not last, Japanese institutional investors went on a buying spree during the U.S. Treasury Department's latest quarterly refinancing operation. The hesitancy of Japanese investors and the willingness of Treasury officials to time the auction to attract them reveals the strong links that have bound the two countries tightly together. The important, almost key, role the Japanese play has raised concerns in the United States that control of monetary policy is becoming unduly influenced by foreign considerations.

The Treasury Department postponed the $26 billion quarterly auction to avoid a three-day Japanese holiday at the start of May. The action was partly in response to reports that Japanese fund managers were unenthusiastic about the bond sale. Reports of unexpectedly strong U.S. economic activity had raised fears of an overheating economy and higher interest rates. Managers were worried that the yield on 30-year bonds would jump as high as 9.25 percent compared with the coupon value of 8.875 percent. Worries over the yen-dollar exchange rate also plagued Japanese managers, and some analysts argued that the dollar's gradual weakening over the past year was due to this concern. Unfortunately, this situation could create a vicious cycle since less Japanese investment in U.S. bonds would reduce demand for dollars, pushing the American currency down and making dollar-denominated instruments even less attractive.

In the end, however, there was no visible reduction in Japan's participation. An estimated 20 percent of the $8.75 billion worth of three-year Treasury notes went to Japanese bidders, carrying an average yield of 8.23 percent. Treasury officials report that the bid-to-cover ratio (the value of bids made divided by the amount accepted) was 2.95, which compares favorably with the last auction's 2.43 ratio. As for the $8.75 billion worth of 10-year notes, Japanese investors bid successfully for 35 to 40 percent. The average yield on the notes was 9.06 percent, a slim margin given the 9 percent coupon. In this case the bid-to-cover ratio was also higher than earlier, coming in at 2.61 versus 2.04.

Traders were pleasantly surprised at the active bidding despite the fact that several major U.S. commercial banks raised their prime lending rate a quarter of a point just before the auction and that Council of Economic Advisors chairman Beryl Sprinkel confirmed that U.S. monetary policy had been tightened. This set the stage for the final day's auction of $8.5 billion